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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 243

ESTATE OF WALTER F. RAU, SR., *Deceased*,
RAYMOND J. SHORB, Administrator with the
Will Annexed, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ELLSWORTH T. SIMPSON
Attorney for Petitioner

NYLEN, GILMORE & SIMPSON
Suite 500, Bowen Building
Washington 5, D. C.

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INDEX

	Page
Opinions Below	2
Appendix A	1a–11a
Appendix B	12a–29a
Jurisdiction	2
Questions Presented	2
Statutes Involved	2–4
Internal Revenue Code, 1954 Section 7442	
Internal Revenue Code, 1954 Section 7482	
Internal Revenue Code, 1939 Section 1112	
Internal Revenue Code, 1939 Section 293(b)	
Internal Revenue Code, 1939 Section 41	
Statement	4
Evidence	5–7
Reasons for Granting Writ of Certiorari	7
I. Survival of Fraud Penalty	7-11
II. Construction of Section 41, I.R.C. 1939	11-12
III. Fraud	12-13
Conclusion	13
Appendix A	
Opinion	1a–11a
Appendix B	
Opinion	12a–29a
Decision of Tax Court	30a

CITATIONS

Arlette Coat Company, Inc. v. Commissioner of Internal Revenue, 14 T.C. 751, 756 (May 4, 1950)	9
Brecher, Pincus v. Commissioner of Internal Revenue, 27 B.T.A. 1108 (1933)	9
Barnes, Arthur S., 36 B.T.A. 764	12
Bates, Ralph B., T.C. Memorandum Decision, 1956	13
Brasington, C. S., Estate of, T.C. Memorandum Decision (P-H 54,012)	13
Briden, Louis L., Estate of, 11 T.C. 1095	8
Burton, Fletcher A., T.C. Memorandum Decision, 1957	13
Dorsey, Victor A., 33 B.T.A. 295 (1935)	9
Ferguson, Walter M., Jr., 14 T.C. 846 (May 10, 1950)	9
Godwin, Arthur M., 34 B.T.A. 485	12
Gould v. Gould, 245 U.S. 15	10

	Page
Helvering v. Mitchell, 303 U.S. 391	8, 9, 11
Henshaw v. Miller, 17 How. 212	7
Huntington v. Attrill, 148 U.S. 657	10
Kerbaugh, Henry S., 29 B.T.A. 1014, Aff'd. 74 Fed. 2d 749, C.C.A. 1	12
National City Bank of New York, Executors v. Commissioner of Internal Revenue, 35 B.T.A. 975	9
Nicholson v. Commissioner, 32 B.T.A. 977	12
Overbeck, George, et al., T.C. Memorandum Decision, 1955	13
Owens v. U. S., 197 Fed. 2d 450 (June 26, 1952)	9
Reimer, Charles Louis, Estate of, 12 T.C. 913	8, 11
Rogers v. Commissioner, 38 B.T.A. 16, Aff'd. 111 Fed. 2d 987 (1938)	9
Schellenberg v. Commissioner, 21 T.C. 1269	11
Schreiber v. Sharpless, 110 U.S. 76	7
Sharpsville Boiler Works Co., 3 B.T.A. 568	12
Simonson v. Granquist, —— U.S. —— No. 83	9
Sullivan v. Associated Billposters Distributors, 6 Fed. 2d 1000	11
Switzer, Glenn L., 20 T.C. 759	13
Tarr, Halley, Estate of, T.C. Memorandum Decision, 1954	13
Thome v. Lynch, 269 Fed. 995	8, 9
U.S. v. Chouteau, 102 U.S. 603, 611	10
U.S. v. Daniel, 6 How. 11	7
U.S. v. Reisinger, 128 U.S. 398	10
U.S. v. Theurer, et al., 215 Fed. 2d 964, C.C.A. 5	9
Wickham v. Comm'r of Internal Revenue, 65 Fed. 2d 527, C.C.A. 8	9
Wiseley v. Commissioner, 185 Fed. 2d 263, reversing, 13 T.C. 253	12-13
Ziegler, Fred A., et al., T.C. Memorandum Decision 1952, Aff'd 207 Fed. 2d 784, C.C.A. 6	9

MISCELLANEOUS:

G.C.M. 9162, Cum. Bull. X-1, 263	8
G.C.M. 15736, Cum. Bull. XIV-48-7832	8
G.C.M. 22326, Cum. Bull. 1940-1	8
Law Opinion, 1091	8
11 Op. Atty. Gen. 280	10
17 Op. Atty. Gen. 433; 23 Ib. 399	10
T.D. 19246	10
Comyns Digest, Administration B. (p. 472)	7

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ESTATE OF WALTER F. RAU, SR., *Deceased*,
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v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RAYMOND J. SHORB, Administrator with the Will Annexed of the Estate of WALTER F. RAU, SR., prays that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Ninth Circuit in the above entitled cause entered on the 9th day of March, 1962; on the 11th day of May, 1962, the Court of Appeals denied Petition for Rehearing and on the 16th day of May, 1962, an order was entered staying issuance of mandate pending petition for Writ of Certiorari to be filed on or before the 16th day of July, 1962.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is printed on Page 1a of Appendix A to this Petition. The decision of the Tax Court of the United States, entered on the 25th day of September, 1959, appears on Pages 29a and 30a of Appendix B hereto.

JURISDICTION

The decision of the Court below was entered on the 9th day of March, 1962 (Appendix A, Page 11a *Infra*). Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the fraud penalty provided for in Section 293(b), Internal Revenue Code, 1939, imposed subsequent to the death of Petitioner's Decedent, survives his death in the absence of statutory provisions authorizing its imposition.

2. Whether the Court below erroneously construed Section 41, Internal Revenue Code, 1939, as applied to the findings of fact by the Tax Court of the United States.

3. Whether the evidence upon which the Tax Court predicated its findings of fraud constitutes clear and convincing evidence.

STATUTES INVOLVED

Section 7442, I.R. Code, 1954, Jurisdiction:

> "The Tax Court and its divisions shall have jurisdiction as is conferred on them by this title, by Chapters 1, 2, 3 and 4 of the Internal Revenue Code, 1939, by Title II and Title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926."

Section 7482, I.R. Code 1954—Courts of Review:

"(a) Jurisdiction—The United States Court of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code in the same manner and to the same extent as decisions of the District Courts in Civil actions tried without a jury; and the judgment of any such court shall be final except that it shall be subject to review by the Supreme Court of the United States upon Certiorari in the same manner provided in Section 1254 of Title 28 of the United States Code".

Section 1112, I.R. Code, 1939—Burden of Proof in Fraud Cases:

"In any proceeding involving the issue whether the Petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner".

Section 293(b) I.R. Code, 1939—Addition to Tax in Case of Deficiency:

"If any part of any deficiency is due to fraud with intent to evade tax, then fifty percentum (50%) of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid in lieu of the fifty percentum (50%) addition to the tax provided in Section 3612(d)(2)".

Section 41. General Rules. Internal Revenue Code 1939:

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall

be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year."

STATEMENT

On the 4th day of January, 1953, at the age of seventy-eight years, Walter F. Rau, Sr., Petitioner's Decedent, died while a resident of Bakersfield, Kern County, State of California. Approximately three years later, on the 17th day of January, 1956, the Commissioner of Internal Revenue mailed to the Administrator of the Decedent's estate a Statutory Notice of Deficiency, proposing deficiencies in income taxes and the fifty per cent fraud penalty for each of the years 1942 through 1947 inclusive. On the 20th day of March, 1956, Raymond J. Shorb, Administrator with the Will Annexed, filed a petition in the Tax Court of the United States, seeking a redetermination of the deficiencies for each of the years in question. Following a hearing in Los Angeles, California, the Tax Court of the United States entered its decision on the 25th day of September, 1959, finding the deficiencies and sustaining the imposition of the fraud penalty as reflected in the following tabulation:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b) I.R.C. 1939
1942	Income	$ 5,901.47	$ 2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

Evidence

During the years under review, Petitioner's Decedent operated several businesses located in the City of Bakersfield, California. Those with which this proceeding is concerned relate to a restaurant and a bar known as the French Cafe and the Southern Wine and Liquor Store. Throughout the years 1942 through 1947, the operation of these enterprises, including one other, was entrusted to a Mr. Robert Webb and to a Mrs. Rose Goldstein, the former as manager and the latter as bookkeeper. Evidence adduced at the trial established that Petitioner's Decedent was an alcoholic and, that he was otherwise in poor health. (R. 392, 393, 394, 404, 407, 415, 426); that, Webb had authority and, in fact, drew most of the checks on the business bank accounts during each of the years involved; (R. 57, 108, 121 and 122) that, for the years 1942 to 1945 Webb's salary was approximately $100.00 per month; (R. 115, 116) that Rose Goldstein received compensation at the rate of $10.00 per month for her services as bookkeeper; (R. 439, 440) and, that she likewise conducted a small public stenographer's business in the lobby of Decedent's hotel. The evidence also showed that deposits in the personal bank account of Rose Goldstein during the years 1943 to 1947, inclusive, aggregated $51,471.89 (R. 461, 568; Exs. 28; 29, 30, 31, 32, 33 and 35). The evidence further showed that Webb deposited the sum of $12,226.83 in his personal bank account during the year 1947 (R. 189, 195; Ex. 12); and, that, during this year, he drew five particular checks on Decedent's bank account using the name of Walter F. Rau, Sr., as payee and also as endorser, the proceeds of which he received in cash. These checks were issued on the dates and in

the amounts reflected in the following schedule: (Exhibit 14)

Date	Check No.	Amount of Check
April 7, 1947	753	$1,000.00
May 2, 1947	806	1,000.00
July 7, 1947	917	3,500.00
June 3, 1946	10	600.00
November 1, 1946	319	1,200.00
Total		$7,300.00

The ensuing chart reflects some of the deposits to Webb's personal bank account for the period corresponding with that appearing in the preceding schedule: (Exhibit 12)

Date	Amount
May 27, 1947	$ 1,200.00
May 29, 1947	916.83
May 29, 1947	3,600.00
June 2, 1947	5,000.00
June 13, 1947	1,000.00
Total	$11,116.83

On the 12th day of May, 1952, Petitioner's Decedent was declared incompetent; and, on the following day, the Superior Court for the County of Kern, State of California, issued an Order appointing Betty Dorsey, a practical nurse, the guardian of the person of Walter F. Rau, Sr., and simultaneously therewith appointed the Bank of America National Trust and Savings Association as the guardian of the Estate of Walter F. Rau, Sr. (Stips. para. 4). From 1945 until his death, Betty Dorsey remained on 24-hour duty in caring for the Decedent (R. 595).

Part of the stipulations filed with the trial Court consisted of a net-worth statement of Petitioner's De-

cedent for the years 1942 to 1947, inclusive. In refuting the deficiencies proposed by Respondent, Petitioner relied upon the increase in Decedent's net worth; Respondent relied upon the oral testimony of Decedent's former employees (Webb and Goldstein). The trial court rejected the net worth and accepted the testimony of Webb and Goldstein in lieu thereof; their testimony was offered 12 to 17 years subsequent to the transactions with which the proceeding was concerned. For the years 1942 through 1947, Petitioner's Decedent paid federal income taxes aggregating $143,458.99 (Stips., joint exhibit 1-A).

REASONS FOR GRANTING WRIT OF CERTIORARI

I. Survival of Fraud Penalty

The principal issue herein involves the question of the survival of the fraud penalty provided for in Section 293(b), Internal Revenue Code, 1939. As announced by this Court, many years ago, actions for the recovery of a penalty do not survive the death of the wrongdoer; *Schreiber* v. *Sharpless,* 110 U.S. 76; *Henshaw* v. *Miller,* 17 How. 212; *U. S.* v. *Daniel,* 6 How. 11.

In *Schreiber* v. *Sharpless, supra,* the Supreme Court referred to Comyns Digest, Administration, B. 15 (page 472), wherein it is stated that no action lies against an executor or administrator upon a penal statute. Quoting from *U. S.* v. *Daniel, supra,* this statement appears:

> "No action will lie against an executor for a personal wrong by the testator, Com. Dig. Administration, B. . . . nor an action upon a penal statute . . . ."

This principle of law has also been recognized in administrative rulings issued by the Commissioner of Internal Revenue; in 1922, the Commissioner published Law Opinion 1091, Cum. Bull. I-1, 422, wherein it was held that the five per cent penalty for failure to pay transportation taxes was a personal punishment and that the penalty abated upon the death of the taxpayer. In G.C.M. 9162, Cum. Bull. X-1, 263, published in 1931, the Commissioner referred to Law Opinion 1091 in ruling that actions on penal statutes were actions *ex delicto* and, therefore, abated upon the death of the tort-feasor; that ruling involved the question of survival of the delinquency penalty for failure to file an income tax return. Again, in 1935, the Commissioner ruled that a transferee was not liable for the delinquency penalty where Decedent failed to file a return, G. C. M. 15736, Cum. Bull. XIV-48-7832, citing *Thome* v. *Lynch*, 269 Fed. 995.

In 1940, however, and relying upon the decision of this Court in *Helvering* v. *Mitchell*, 303 U.S. 391, decided March 7, 1938, the Commissioner of Internal Revenue issued G. C. M. 22326, Cum. Bull. 1940-1, ruling that the fifty per cent penalty for fraud, provided for by Section 293(b) of the Revenue Acts of 1936 and 1938 did not abate upon the death of the taxpayer. This drastic departure from well-recognized principles of law, by administrative action, received judicial approval in the case of *Estate of Louis L. Briden*, 11 T.C. 1095, decided December 31, 1948, and again, by the same Court, in *Estate of Charles Louis Reimer*, 12 T.C. 913, decided May 31, 1949. In both of these cases, the Tax Court cited G. C. M. 22326, and adopted the rationale of that ruling in interpreting the decision of this Court in *Helvering* v. *Mitchell, supra.* The most

significant aspect of this matter lies, not so much in the fact that this novel doctrine is of administrative origin, but rather in the fact that the question of the survival of the fraud penalty was neither considered nor even mentioned in *Helvering* v. *Mitchell, supra.*

Prior to the *Briden and Reimer* cases, the Federal courts had consistently held that the penalty for fraud abated upon the death of a taxpayer; *Thome* v. *Lynch*, 269 Fed. 995; *U. S.* v. *Theurer, et al.*, 215 Fed. 964, C. C. A. Fifth (1914); *Wickham* v. *Commissioner of Internal Revenue*, 65 Fed. 2d 527, C. C. A. Eighth (1933); *National City Bank of New York, Executors* v. *Commissioner of Internal Revenue*, 35 B.T.A. 975 (1937). As recently as May 5, 1962, October Term 1961, the Supreme Court of the United States held that a penalty did not survive bankruptcy, *Simonson* v. *Granquist*, ... U.S. .... No. 83.

The Tax Court's refusal to recognize the "50 per cent addition to the tax" as a penalty in the *Briden* and *Reimer* cases conflicts not only with the decisions of its predecessor, the Board of Tax Appeals, but it also conflicts with its own later decisions. *Pincus Brecher* v. *Commissioner of Internal Revenue*, 27 B.T.A. 1108 (1933); *Victor A Dorsey*, 33 B.T.A. 295 (1935); *Rogers* v. *Commissioner*, 38 B.T.A. 16, aff'd. 111 Fed. 2d 987 (1938); *Arlette Coat Company, Inc.* v. *Commissioner of Internal Revenue*, 14 T.C. 751, 756 (May 4, 1950); *Walter M. Ferguson, Jr.*, 14 T.C. 846 (May 16, 1950); *Fred A. Ziegler, et al.*, T.C. Memo., 1952, aff'd. 207 Fed. 2d 784, C.C.A. Sixth.

In *Owens* v. *U. S.*, 197 Fed. 2d. 450, decided June 26, 1952, the Court of Appeals for the Eighth Circuit stated:

"The sole question for decision is whether there was a sufficient evidentiary basis for the determination by the District Court that appellant taxpayer was liable for *fraud penalties* under section 26 U.S.C.A. 293(b) . . . ." [Emphasis supplied.]

Oddly enough, the Tax Court and the United States Courts of Appeals repeatedly regard and construe section 293(b), Internal Revenue Code, 1939 (and similar provisions of other revenue acts), as providing for a penalty. The exception, however, apparently arises when the issue before the courts involves the question of the survival of the penalty; then, and only then, so it seems, do the courts view the "50 per cent addition" as something other than a penalty. Presumably, therefore, it is a penalty when imposed upon the living but is transformed into something else when imposed upon the dead. Of singular significance is the fact that the Commissioner, himself, considers the "50 per cent addition" as a penalty; this is evidenced by the Statutory Notice of Deficiency mailed to Petitioner's decedent wherein this addition is specifically designated as a "293(b) penalty." As such, it involves the infliction of punishment; *U. S.* v. *Reisinger,* 128 U.S. 398; *Huntington* v. *Attrill,* 148 U. S. 657. The character or nature of the penalty is not altered by the mode in which it is inflicted, whether by suit or criminal prosecution; *U. S.* v. *Chouteau,* 102 U.S. 603, 611. The "50 per cent addition" was administratively construed as a penalty in 17 Op. Atty. Gen. 433; 23 Id. 399; T. D. 19246; and, as a penal duty in 11 Op. Atty. Gen. 280. Statutes should receive a sensible construction such as will effectuate the legislative intention and avoid, if possible an unjust or absurd construction, *Gould* v. *Gould,* 245 U.S. 15.

In reaching its decision in *Estate of Charles Louis Reimer, supra,* the Tax Court construed the decision of *Helvering* v. *Mitchell, supra,* as admitting of no construction other than that the 50 per cent fraud penalty was imposed as a remedial measure to compensate the United States for loss resulting from the wrongful act committed by the taxpayer. It should be noted, however, that the Tax Court was careful to observe that the question of the survival of the remedial sanction, imposed under Section 293 (b), was not before the Supreme Court nor considered by it in reaching its decision. In conjunction with *Helvering* v. *Mitchell, supra,* the Tax Court also relied upon *Sullivan* v. *Associated Billposters Distributors,* 6 Fed. 2d. 1,000, but, in so doing, it seemed equally careful to avoid the salient aspect of that opinion, to the effect that the mere fact that a statute is remedial, and not penal, is not sufficient to make a cause of action for tort arising under it survive the death of the wrongdoer. The confusion thus created by *Helvering* v. *Mitchell, supra,* presents an urgent need for judicial clarification in this area.

II. Construction of Section 41, I. R. C., 1939

In recognizing the restriction of reasonableness placed upon the Commissioner in the exercise of his discretion pursuant to the provisions of Section 41, I.R.C., 1939, the Court below ignored its essential requirement in that the method employed must *clearly* reflect income (italics supplied). In its opinion, the Court below cited *Schellenberg* v. *Commissioner,* 21 T.C. 1269, 1277, wherein this requirement was stressed by the Tax Court. In resolving this question, it is only necessary to consider the nature of the evidence upon which decedent's income was actually determined,

namely, unsubstantiated oral testimony elicited from two former employees after the lapse of many years. If, however, consideration is also given to the unrealistic net profits resulting from the Commissioner's method, as approved by the Tax Court, the deficiencies are purely speculative and arbitrary; the data set forth in the following chart supports this contention:

Year	Treasury Dept. Statistics National Average	Per Tax Court Findings
1942	5.0	24.02
1943	6.63	32.93
1944	5.28	24.35
1945	5.96	19.37
1946	5.98	26.83
1947	4.88	45.00

As further proof of the speculative character of the deficiencies, the trial judge observed that Petitioner had generated "smoke" relative to the personal financial transactions of both Webb and Goldstein (R. 256); he also conceded that their testimony contained minor inconsistencies (Appendix B, Page 27a, *Infra*). In contrast, however, the net worth, as stipulated, contained no discrepancies or inconsistencies of any kind. It is submitted, therefore, that the method employed by the Commissioner violates the requirement of reasonableness and it likewise fails to reflect the income *clearly*.

III. Fraud

As to the issue of fraud, there are countless decisions holding that it must be established by clear and convincing evidence. *Sharpsville Boiler Works Co.*, 3 B.T.A. 568; *Henry S. Kerbaugh*, 29 B.T.A. 1014, Aff'd. 74 Fed, 2d 749, C.C.A. 1 (1935); *Nicholson* v. *Commissioner*, 32 B.T.A. 977; *Arthur M. Godwin*, 34 B.T.A. 485; *Arthur S. Barnes*, 36 B.T.A. 764; *Wiseley* v. *Com-*

missioner, 185 Fed. 2d. 263, C.C.A. Sixth, reversing 13 T.C. 253; *Glenn L. Switzer*, 20 T.C. 759 (1953).

In support of its finding of fraud, the Tax Court noted that the net-worth method, as urged by Petitioner, disclosed large deficiencies for several of the years under review. In other cases, however, the Tax Court has held that large understatements of income over a period of several years, without more, is insufficient for sustaining the fraud penalty. *Estate of Hallie Tarr*, T.C. Memo Decision, 1954; *Ralph B. Bates*, T.C. Memo Decision, 1956; *Estate of C. S. Brasington*, T.C. Memo Decision, decided December 31, 1953 (Pentice Hall 54,012); *Fletcher A. Burton*, T.C. Memo Decision, 1957.

It has also been held that stipulated deficiencies do not support the determination that they were due to fraud within the meaning of Section 293(b), I.R.C., 1939, *George Overbeck, et al.*, T.C. Memo Decision, 1955.

CONCLUSION

Based on the foregoing reasons, particularly with respect to the question of the survival of the fraud penalty, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

ELLSWORTH T. SIMPSON
Attorney for Petitioner

NYLEN, GILMORE & SIMPSON
Suite 500, Bowen Building
Washington 5, D. C.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 16,823

Mar. 9, 1962.

ESTATE OF WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator with the Will Annexed, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Petition to Review a Decision of the Tax Court of the United States

Before: BARNES and KOELSCH, Circuit Judges, and YANKWICH, District Judge

KOELSCH, Circuit Judge:

This is a petition by Raymond J. Shorb, as administrator with the will annexed of the estate of Walter F. Rau to review a decision of the Tax Court of the United States determining a deficiency in the income tax of Walter F. Rau for the years 1942 through 1947, with the addition of 50 per cent to the tax for fraud for each of those years, assessed pursuant to the provisions of section 293(b) of the Internal Revenue Code of 1939.

The Tax Court slightly reduced the 1942 tax deficiency and addition assessed by the Commissioner and as modified confirmed his computation and determination for each year as follows:

Year	*Kind of Tax*	*Deficiency*	*Addition to Tax*
1942	Income	$ 5,901.47	$ 2,778.22
1943	Income & Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

During the tax years in question Rau had earnings from several sources but the subject of this appeal concerns his

income from two businesses—the French Cafe and a bar and a liquor store known as the Southern Wine & Liquor in Bakersfield, California, where he also operated a hotel. The Commissioner determined that the deficiencies were due to Rau's fraudulent understatement in his tax returns of his gross income from the cafe and the bar, coupled with the charging of fictitious expenses and purchases against their purported earnings.

On this review Rau's administrator makes three basic contentions: first, that the Commissioner should have calculated Rau's tax liability upon the net worth method of computing taxable income instead of relying upon specific omissions from income; second, that the evidence is insufficient to sustain the Tax Court's finding that Rau was guilty of making fraudulent returns with intent to evade income tax; and third, that section 293(b) may not be invoked to permit an addition to the actual tax deficiency.

Rau's administrator concedes that Rau failed to accurately report his income in any of the years 1942 through 1947; he also admits that Rau underpaid income tax for the years 1942 through 1945, but he argues that the actual deficiency for the latter years was far less than that determined by the Tax Court and asserts that Rau in fact overpaid income tax for 1946 and 1947; he vigorously contends that the finding of fraud is clearly erroneous and he urges that the death of the taxpayer prior to the assessment of the deficiencies precludes the imposition of the "fraud penalty" provided for by section 293(b).

In making the adjustments and arriving at the decision to increase the assessment, the Commissioner principally relied upon information gained from Robert R. Webb and Rose Goldstein, former employees of Rau.

Webb had been the manager of Rau's hotel and was also in charge of the receipts of the cafe and bar; he had received the receipts and made the bank deposits for both

businesses daily; he also kept a daily record in a "year book" of the amounts deposited.

Goldstein had kept Rau's books, made out his income tax returns for all the several years except 1947 and when Webb was absent from work because of sickness or for other reasons, had handled the receipts. She used the "year books" as the basis for maintaining the cash journal for each business and used the cash journal in conjunction with the checkbook as the basis for preparing Rau's income tax returns.

At the hearing before the Tax Court Webb and Goldstein depicted Rau as an astute and successful business operator who maintained fictitious books and surreptitiously juggled his receipts in order to evade the full impact of the income tax laws upon his earnings; their testimony disclosed, with the precision essential to justify the deficiency assessments levied by the Commissioner and sustained (with but slight modification) by the Tax Court, the amount of taxable income which Rau had not reported in his returns. Accordingly, if these witnesses were credible and their testimony regarding the devious manner in which Rau handled this income and kept his accounts can be believed, then the evidence overwhelmingly supports the Tax Court's finding that the shortage constituted a calculated concealment by Rau of his true income in order to lessen tax liability.[1]

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[1] In substance, their testimony was that Webb did not bank the entire receipts of the cafe and bar, that, complying with Rau's instruction, Webb first deducted a specified amount in cash from the sums turned in to him by the steward of the cafe and the bartenders and only deposited the remainder. He kept the withheld moneys in the hotel safe where they were allowed to accumulate until removed by Rau at the end of each month; these portions of the receipts of each business were not entered in the "year books" and were never reflected in Rau's income tax returns. The witnesses further stated that sometimes, after the deduction was made from the cafe receipts, not much remained; on such occasions Rau directed Webb to make the deposit and purported

Rau's administrator, however, urges that the Tax Court should have rejected the Commissioner's determination (based upon statements that Rau omitted specific amounts of income from his tax returns) and instead arrived at his income and his tax liability from the proof submitted by Rau's administrator of his increase in net worth during the several tax years.[2] Especially, says the administrator, should the Tax Court have followed this course where the deficiency indicated by accepting "unsubstantial oral testimony" of specific omissions from income is exhorbitant and unrealistic as compared to the deficiency disclosed by his net worth proof. Moreover, continues the administrator, the proof of fraud falls far short of being clear and convincing;[3] he points out that the finding of fraud rests

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receipts for the cafe "look respectable" by adding a check drawn on the cafe account in a sufficient amount to increase the deposit to more than $300.00; he further instructed Webb to enter these checks in the checkbook as payment for supplies and the amount was treated as a business expense in his income tax returns. Webb and Goldstein further testified that the cafe steward's "cash payable" for supplies and expenses during the day were not included in the sum entered in the "year books" and cash journal as income, but that these payments were recorded as expenses in the cash journal and were so reflected in Rau's tax returns. Goldstein also related two other specific instances, one in 1943, the other in 1944, when false figures were employed to lessen tax: The witness testified that in both years after she computed Rau's income tax he told her to "raise the purchases" for the French Cafe in order to reduce his tax and she complied with those instructions. The cash journal and tax returns for the years 1943 and 1944 tend to corroborate her, for there is a discrepancy between the amount expended for the item of "purchases" for the French Cafe. The amounts in the respective tax returns are larger by approximately $15,000.00 in 1943 and $10,000.00 in 1944 than those shown in the cash journal.

[2] Holland v. United States, 348 U.S. 121 (1954).

[3] Section 7454 imposes the burden of proving fraud on the Commissioner; the cases uniformly hold that a finding of fraud must rest upon evidence that is clear and convincing. See Lusk v.

largely upon testimony of two employees who occupied positions of trust in which they were in charge of Rau's money and might well have "siphoned off funds belonging to their employer" and manipulated his records for their own protection in an effort to conceal from him their embezzlement.

Careful consideration of these contentions convinces us that each of them lacks merit. In Schellenbarg v. Commissioner, 21 T.C. 1269, 1277, the Tax Court pointed out that "Section 41 of the Code provides, in the event the method of accounting utilized by the taxpayer does not clearly reflect income that 'the computation shall be in accordance with such method *as in the opinion of the Commissioner* does clearly reflect the income.' [Italics supplied.] It is thus apparent that the choice as to the method of reconstruction of income lies with the Commissioner and not the taxpayer, the only restriction being that the method adopted be reasonable."[4] The fact that there is a substantial discrepancy between Rau's income as it appears from his books and his income calculated on the basis of his net worth would alone entitle the Commissioner to invoke the statute. Despite the stipulation that the net worth statement prepared by Rau's administrator and entered into evidence "set . . . forth the assets and liabilities of Walter F. Rau, Sr. on the dates as indicated," the Commissioner was not bound to base his computation upon those figures. The net worth method of determining income "is itself only an approximation" (Holland v. United States, 348 U.S. 121 at 129 (1954)), and although an acceptable mode

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Commissioner, 250 F. 2d 591 (7th Cir. 1957), cert. denied 357 U.S. 932 (1958); Bond v. Commissioner, 232 F. 2d 822 (4th Cir. 1956), cert. denied 352 U.S. 878 (1956); Dreiborg v. Commissioner, 225 F. 2d 216 (6th Cir. 1955).

[4] Section 41 of the Internal Revenue Code of 1939 (26 U.S.C.A. 1952 ed. Section 446 (b); Furnish v. Commissioner, 262 F. 2d 727 (9th Cir. 1958).

of proof, is not necessarily superior to some other recognized method of establishing that fact. Here the Commissioner chose the direct proof given by two persons who were in a position to know if any sums were not accounted for, and who gave those sums with a high degree of precision.

While it is true that the sums of the specific omissions in each of the several tax years greatly exceed the differences between the net income Rau actually reported and his net income calculated upon the increase in net worth method of computing income, and conceding for present purposes that the testimony of Rau's former employees was not corroborated, nevertheless we are not convinced that these facts either separately or taken together warrant a reversal of the decision.

The Tax Court personally observed the witnesses Webb and Goldstein, and from that vantage point was in a position to evaluate their testimony in the light of their attitude and demeanor while being interrogated. That the witnesses created a favorable impression both as to their integrity and the accuracy of their information is clear, for the court declared that "The testimony of Robert Webb and Rose Goldstein was strong and convincing: . . . . Although there may have been minor inconsistencies, the main thrust of their testimony was credible, consistent, powerful and persuasive."

We cannot say that the Commissioner acted arbitrarily in basing his determination upon the statements of such witnesses or that the Tax Court erred in preferring his proof.

The Commissioner also met his burden of establishing fraud: the net worth computation itself demonstrates that Rau understated substantial amounts of income in all but one of the seven tax years.[5]

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[5] The appellant states in his brief that the net worth computation shows the net income was overstated in 1946 and 1947 but he is in error.

"Mere omission of reportable income is not of itself sufficient to warrant a finding of fraud in an income tax case [citations omitted]. However, repeated understatements in successive years when coupled with other circumstances showing an intent to conceal or misstate taxable income present a basis on which the Tax Court may properly infer fraud." Furnish v. CIR, 262 F. 2d 727, 728 (9th Cir. 1958).[6]

The testimony of Webb and Goldstein confirms that the understatement was fraudulent.

The remaining question is whether the addition permitted by section 293(b) of 50 per cent to the deficiency may be validly assessed after the taxpayer has died. At the outset, the Commissioner, relying upon the statement of the Tax Court that no such issue was raised by the petition in that court, contends the matter cannot now be urged. Rule 7 (B) (4) [now Rule 7 (a) (2) (c) (4) (ii) (d)] of the Tax Court requires the petition to contain clear and concise assignments of each and every error assertedly committed by the Commissioner. The petition before us includes the statements that the Commissioner erred "(1) . . . in proposing deficiencies and penalties for the years 1942, 1943, 1944, 1945, 1946 and 1947 [and] (2) in determining that petitioner is liable for the 50 per cent fraud penalty . . . " for those years. Although these statements, because of their generality, may not strictly comply with the Rule, nevertheless we think that taken together they are adequate to raise the issue, to which the Tax Court gave some consideration if only in passing.

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[6] The administrator urged as a bar to the assessment of the deficiency the prescription of the three-year statute of limitation provided by section 275 (a) of the Internal Revenue Code of 1939. However, a further section (276) renders the limitation inapplicable "[i]n the case of a false or fraudulent return with intent to evade tax . . . ."

Rau's administrator predicates his contention that the statutory provision may not be invoked to impose liability on a decedent's estate growing out of the fraud of the deceased taxpayer, on the assumption that the "'addition' [of 50 per cent to the tax] was intended as a penalty for such wrongdoing." His entire argument is devoted to the development of the thesis that section 293(b) is a penal provision and that the assessment is a fine intended as a punishment upon an offender. If section 293(b) imposed a criminal sanction the issue could be easily and readily resolved because of the well settled rule that "[a]t common law, actions on penal statutes do not survive . . . " the death of the wrongdoer. Schreiber v. Sharpless, 110 U.S. 76, 80 (1884). But in Helvering v. Mitchell, 303 U.S. 391 (1938) the Supreme Court, having under consideration the purpose of section 293(b),[7] held that it was remedial rather than penal, and a type of legislative enactment "provided primarily as a safeguard for the protection of the revenue and to reimburse the government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud."

However, the proposition urged by the administrator—that the death of the taxpayer terminated the right to impose the addition—is not answered by simply pointing to the Supreme Court's classification of the addition as not penal and the statute as remedial and not punitive. It cannot be doubted that the right accrues only when a tort in the nature of a fraud has been committed by a taxpayer. Under the ancient common law as exemplified in the numerous decisions referred to in Sullivan v. Assoc. Billposters and Distributors, 6 F. 2d 1000 (2nd Cir. 1925) the rule was that death of either the injured party or the wrongdoer abated the right of action for torts. The pre-

[7] Section 293 (b) of the Revenue Act of 1939 is identical to section 293 (b) of the Revenue Act of 1928 which governed Helvering v. Mitchell, 303 U.S. 391 (1938).

cise basis for this treatment of tort claims is now lost in the mists of antiquity[8] but in any event, with the passage of time the rule came to be regarded as "one of the 'least rational parts' of the law";[9] and courts began to either narrow its broad sweep (Sullivan v. Assoc. Billposters,

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[8] In his work entitled "Law of Torts" (2nd ed.) 1955, Mr. Prosser states at pages 206 and 207 that the "origins of the rule that personal tort actions die with the person of the plaintiff or the defendant is rather obscure . . . the more so as contract actions which were equally 'personal' were held to survive the death of either. The best conjecture on the subject is that it was the development of the tort remedy as an adjunct and incident to criminal punishment. . . . . Since the defendant could not be punished when he was dead it was natural to regard his demise as terminating the criminal action and the tort liability with it."

"Sir Frederick Pollock, in his Work on Torts (11th ed. p. 61), discussing the effect produced on liability for a death of either the person wronged or the wrongdoer, declares it to be one of the 'least rational parts' of the law; and he also declares that 'when once the notion of vengeance has been put aside, and that of compensation substituted, the rule 'actio personalis moritur cum persona' seems to be without plausible ground. First, as to the liability, it is impossible to see why a wrongdoer's estate should ever be exempted from making satisfaction for his wrongs. It is better that the residuary legatee should be to some extent cut short than that the person wronged should be deprived of redress.' The same writer, on page 71, after stating the rule that the right of action survives against the executor in cases where the decedent has added to his own estate property or the value or proceeds of property belonging to another, states that the rule is 'limited to specific acquisitions or their value. It does not include the recovery of damages, as such, for a wrong, though the wrong may have increased the wrongdoer's estate in the sense of being useful to him or saving him expense'"

The last quoted matter is extracted from Sullivan v. Assoc. Billposters & Distributors, 6 F. 2d 1000 at 1003.

[9] The passage appears in Sullivan v. Assoc. Billposters & Distributors, supra, and is a quotation contained in Pollock on Torts, 11th ed. p. 61.

supra), or, being of the opinion that the logical progression of the law in the light of changed concepts and conditions had clearly necessitated a modification of the rule, curtailed its application. Barnes Coal Corp. v. Retail Coal Merchants Assn., 128 F. 2d 645 (4th Cir. 1942). Thus, at an early day the courts engrafted upon the rule the qualification that those actions ex delicto survived and could be prosecuted against a decedent's personal representative where the tort consisted of the appropriation by a wrongdoer of specific property by which, or by the proceeds of which, the assets of his estate were increased. In the instant case, however, it is readily apparent that the Government cannot bring itself within that exception, so that if the early law is given a broad application the result would be that section 293(b) was erroneously applied in this situation. But a number of circuits have concluded that the right created by section 293(b) does survive because, to use the language of the First Circuit in Kirk v. Commissioner, 179 F. 2d 619, 622 (1950); 15 A.L.R. 2d 1031, they have "fel[t] at liberty to abandon enrichment of a decedent's estate as any criterion of survivability in cases like this because it is evident from the cases cited last above, and those cases cited therein, that the enrichment concept of the early law of survival was the product of archaic legal preconceptions identifying the representative personally with the estate in his charge which have little or no place in the law today." See Seadron's Estate v. Commissioner, 212 F. 2d 188 (2nd Cir. 1954); Lee v. Commissioner, 227 F. 2d 181 (5th Cir. 1955) and Reimer's Estate v. Commissioner, 180 F. 2d 159 (6th Cir. 1950). A number of these decisions are expressly based upon the reasoning of the Tax Court in Reimer's Estate v. Commissioner, 12 T.C. 913, 920, 921 (1949), which is epitomized in the statement that "The primary purpose of taxation is to obtain money which the sovereign may use in the performance of its many governmental functions. The direct result of a taxpayer's filing of a fraudulent income tax return which

understates his true tax liability is to deprive the sovereign of money it is entitled to receive and obligated to collect. It also makes it necessary for the Government to expend other public funds in order to uncover the fraud and collect the proper amount of the tax due. These are monetary losses. Consequently we feel that the taxpayer's wrongful act is in the nature of an injury to the property of the United States."

We find ourselves in accord with the several circuits and with the Tax Court in Reimer, *supra*, and conclude the addition should be upheld.

The judgment is AFFIRMED.

(Endorsed) Opinion Filed Mar. 9, 1962.

Frank H. Schmid, Clerk.

APPENDIX B

T. C. Memo. 1959-117

TAX COURT OF THE UNITED STATES

Docket No. 61480

Filed June 8, 1959

ESTATE OF WALTER F. RAU, SR., DECEASED, RAYMOND J. SHORB, ADMINISTRATOR WITH THE WILL ANNEXED, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Ellsworth T. Simpson, Esq., for the petitioner.

J. Earl Gardner, Esq., and *John Schessler, Esq.*, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Respondent determined deficiencies in tax and additions to tax for fraud, as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1942	Income	$ 6,230.87	$ 3,115.44
1943	Income and Victory	37,390.14	25,692.50
1944	Income	32,173.36	17,952.10
1945	Income	45,138.58	22,569.29
1946	Income	10,638.16	5,319.08
1947	Income	17,214.11	8,607.06

By amended answer, the respondent claimed additional deficiencies in tax and additions to tax for fraud, as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1943	Income and Victory	$15,523.36	$ 7,761.69
1944	Income	21,551.97	10,775.98
1945	Income	1,154.23	577.12
1946	Income	1,665.56	832.78

The principal issues are (1) whether the taxpayer filed false income tax returns for the years 1942-1947, by knowingly understating receipts and overstating purchases; and (2) whether petitioner is entitled to have the basic deficiencies determined on the basis of a net worth statement rather than on the basis of specific adjustments made by the Commissioner.

FINDINGS OF FACT

Some of the facts have been stipulated and, as stipulated, are incorporated herein by reference.

On May 12, 1952, the taxpayer, Walter F. Rau, Sr., was declared incompetent by court order. He died on January 4, 1953; he was then approximately 78 years of age. A bank was appointed executor, but it withdrew, and on March 9, 1955, Raymond J. Shorb was appointed as administrator with the will annexed.

Mary Agnes Rau, wife of decedent, died on December 27, 1942; he never remarried. Decedent had no dependents during the taxable years 1942 through 1947. He filed a separate return for 1942 on a community property basis. His individual returns for all the taxable years were filed with the collector of internal revenue at Los Angeles, California.

Commencing in 1932, and continuing to August 7, 1947, decedent, as sole proprietor, operated a business known as the Southern Hotel in Bakersfield, California. He owned and operated a business known as the French Cafe, located in the Southern Hotel, from 1934 to May 6, 1946, at which time he formed a partnership with Phil Bender to operate that business. Decedent had a two-thirds interest in the partnership, which was terminated on August 16, 1947. On June 1, 1947, an equal partnership consisting of decedent, Phil Bender, and Robert R. Webb was formed for the purpose of conducting a business also known as the

French Cafe, which was located across the street and about a block away from the Southern Hotel. This partnership continued to operate throughout the remainder of the year 1947. From 1934 to August 12, 1947, decedent, as sole proprietor, operated a business known as the Southern Wine and Liquor Store (hereinafter sometimes referred to as the Southern Bar or the Southern Wine and Liquor Bar), located in the Southern Hotel. Beginning in June, 1944, and continuing throughout the years in question, decedent owned and operated the Edmund Hotel in Venice, California. From 1944 to 1947, inclusive, he owned and operated the Sea Spray Hotel in Venice, California. In June, 1946, decedent purchased the Taft Hotel in Taft, California. He owned and operated this hotel together with its restaurant and bar from June 1946 throughout the remainder of the period here involved.

The books and records of the French Cafe, Southern Hotel, and the Southern Bar were maintained on the cash basis of accounting under a single entry method of bookkeeping. Decedent made no entries in these books and records.

Robert Webb (hereinaffer referred to as Webb) was hired as clerk of the Southern Hotel in 1932. In 1934 decedent gave Webb the title of manager. During the years 1942 to 1945, or 1946, Webb's hours of employment were from 7:00 A.M. to 7:00 P.M. In 1945 or 1946, an extra clerk was hired to assist Webb, and thereafter Webb's hours of employment were from 10:00 A.M. to 5:00 P.M. For some years Webb received $100 a month and room and board. In 1945 his salary was raised to $45 a week.

During 1940 and 1941 Webb received illegal income in the form of commissions on bets on horse racing using a telephone in the Southern Hotel for this operation. On some days his commission would run as high as $15. Webb did not want to stop this illegal business of taking

bets on horse racing, but the business was taken away from him.

Webb's hotel duties included hiring and supervising bell boys and maids, keeping order in the hotel, and acting as room clerk. He also, at all times material herein, had charge of the receipts of the French Cafe and Southern Bar. He had nothing to do with the hiring or firing of employees of the French Cafe, Southern Bar, or other businesses of decedent.

Rose Goldstein was employed by the decedent in 1935 as a bookkeeper. She married Jack Longway on July 22, 1942. She kept the books of the Southern Hotel, the French Cafe, and the Southern Bar. Her duties as bookkeeper for the Southern Hotel and the Southern Bar ceased when the Southern Hotel was demolished in August 1947. Her duties as bookkeeper for the French Cafe ceased on May 6, 1946 when decedent formed a partnership with Phil Bender to operate this business. She substituted for Webb when he was on vacation or absent on account of illness. For her services to decedent she received $10 per month, one or two meals a day, and desk space in the lobby of the hotel where she conducted a business of her own.

The services Rose Goldstein performed for decedent did not take up much of her time. In her own business she realized income from services rendered as a public stenographer, notary public, mimeographing, telephone answering, and direct mail advertising. She also prepared income tax returns and did some court reporting. After her marriage in 1942 she continued to operate this business under the name of Rose Goldstein.

Decedent had bank accounts in the Bank of America National Trust and Savings Association, Bakersfield, California for the French Cafe, Southern Bar, and the Southern Hotel, and also a bank account for the French Cafe in The Anglo California National Bank, Bakersfield, California.

He had a personal account and a safety deposit box at the Anglo Bank. Webb was authorized by the decedent to draw checks on the bank accounts of the French Cafe and Southern Bar, and he drew checks on these accounts to meet payroll and other expenses.

Webb endorsed the name of decedent on checks drawn by Robert Webb, payable to decedent on the dates and in the amounts set forth in the following schedule:

Date	Check No.	Amount of Check
April 7, 1947	753	$1,000.00
May 2, 1947	806	1,000.00
July 7, 1947	917	3,500.00
June 3, 1946	10	600.00
November 1, 1946	319	1,200.00
Total		$7,300.00

Practically all of the deposits for all of the taxable years to the various bank accounts of decedent's businesses, including those to his personal bank account, were made by Webb in the form of cash and checks. Webb went to the bank every day, sometimes three or four times a day, to make deposits. The amounts deposited as the receipts of the French Cafe and the Southern Bar were entered daily during the years 1942 through 1947 in "year books", consisting of a diary-type volume for each year with a half page or page for each day of the year.

Decedent sometimes gave Webb cash and told him to convert the cash into thousand dollar bills. Decedent would put these bills in his safe deposit box at the Anglo Bank. On one occasion when Webb accompanied decedent to the bank, decedent had twenty $1,000 bills when he returned from a visit to the box and bought $20,000 worth of war bonds. Decedent told Webb he made this purchase and Webb saw him make it.

Every morning during the years 1942 to May 6, 1946, when Webb reported for work, the steward or the cashier

of the French Cafe would bring him a sheet containing figures showing its receipts for the preceding day, the cash register tape, and the cash receipts. The amount of the daily receipts as shown on the cash register tape would be entered at the top of the sheet, and from this amount there would be deducted "payouts" for the expenses of the day. Following instructions received by him from decedent Webb would deduct and remove from the net receipts of the day thus determined $10 every day of each month and in addition thereto $100, $150 or $200, on Saturdays, Sundays, and holidays. Usually the amount deducted was shown on the daily sheet, but in some instances the deduction made was not reflected on the sheet.

The $10 deducted by Webb each day from the net receipts of the French Cafe was placed by Webb in an envelope marked "French Cafe" and this envelope was placed in decedent's safe. Decedent instructed him to do this. At the end of the month the envelope would contain an amount ranging from $280 to $310 depending on the number of days in the month. Webb would then take this amount out of the envelope and give it to decedent, who would have it deposited in his personal bank account, put it in his safe deposit box at the Anglo Bank, or put it in his pocket. When the money was removed, the envelope would be destroyed, and Webb would start the next month with a new envelope.

The larger amounts deducted from cash receipts on Saturdays, Sundays and holidays were placed in another envelope marked "French Cafe" and on the outside of this envelope Webb would note the amount deducted and the date of the deduction. Webb would get the receipts of a Saturday, Sunday, or holiday on the morning of the following day, show them to the decedent, and he would tell Webb the amount to be deducted from the receipts in addition to the $10 daily deduction.

At times, after deducting the usual $10 from the daily net receipts of the French Cafe or the larger amount on a Saturday, Sunday, or holiday the resulting figure would be below $300. Webb was instructed by decedent in such instances to make out a check payable to cash in an amount which, when added to the receipts as thus reduced, would produce a figure in excess of $300. Such check would be drawn upon the account of the French Cafe, and the proceeds thereof would be added to the receipts. The purpose of adding the proceeds of such check to the receipts, after the $10 or larger deduction had been taken from the actual net receipts, was to make the receipts and deposit for the day "look respectable". Although the addition of the amount of the check to the net receipts for the day increased the receipts and the deposit for that day by that amount, the increase was neutralized for tax purposes by the fact that the amount of the check was falsely entered on the check stub as an expenditure for supplies and was entered on decedent's books as such an expenditure by the bookkeeper. Pursuant to instructions she received from decedent and Webb the amounts of these checks were treated as expenditures for supplies during each of the years 1942, 1943, 1944, 1945, and up to May 6, 1946, even though these amounts did not represent expenditures for supplies.

The Southern Bar operated on two shifts, one ending at 4:00 p.m. and the other ending at midnight or 2:00 a.m. Webb would receive the cash receipts from the bar from the day bartender at 4:00 p.m. and from the night bartender the following morning. He would then total the cash receipts for the day, and deduct the amount of "payouts" for expenses. Decedent instructed him to deduct and remove each day from the net receipts thus determined the amount of $25 and he followed these instructions. Webb put the $25 daily withdrawal in an envelope marked "Bar" which was placed in the safe. Decedent also instructed him to deduct an additional larger amount on

Saturdays, Sundays and holidays. This amount was usually $100, but when the receipts were exceptionally large, the amount was $150 or $200. Decedent decided how much would be "taken off" on such days. The larger amounts thus deducted on weekends and holidays were placed in the comparable envelope for similar deductions made on such days from the receipts of the French Cafe. When decedent was absent, Webb would deduct $100 but would save the cash register tape for decedent who would examine it on his return. The practice of deducting $25 a day started at the beginning of 1942 and continued until a short time before the Southern Bar was closed in August 1947. The practice of deducting additional large amounts on weekends started at the beginning of October 1942 and continued at least through July 1947.

When Webb was absent on leave or because of illness, Rose Goldstein handled the receipts of the French Cafe and Southern Bar. On these occasions the same deductions were taken from the daily and weekend receipts of these businesses that were taken by Webb when he was present. Decedent told her the amounts to be taken as deductions from the daily and weekend receipts.

Every day, except when he was absent, Webb recorded the daily receipts of the French Cafe and the Southern Bar in "year books" during the years 1942 through August 10, 1947. When he was absent, Rose Goldstein recorded the receipts from 1942 to May 6, 1946 in the case of the French Cafe, and from 1942 to August 10, 1947 in the case of the Southern Bar.

The receipts for the French Cafe recorded in the "year books" were not the actual receipts for the years 1942 to May 6, 1946, inclusive. Disregarding any additions to receipts represented by the proceeds of the foregoing checks payable to cash which were falsely treated as expenditures for supplies and which thus neutralized such additions, the recorded receipts of the French Cafe during

that period were understated in the amount of $10 per day on every calendar day and were also understated in addition by a least $100 for each Saturday, Sunday, and holiday.

The receipts for the Southern Bar that were recorded in the "year books" were not the actual receipts for the years 1942 to August 10, 1947 inclusive. The recorded receipts were understated in the amount of $25 per day on every calendar day throughout that period and were also understated in addition by at least $100 for each Saturday, Sunday, and holiday from the beginning of October 1942 until at least the end of July 1947. The aggregate of such understatements of receipts from the Southern Bar for 1942 was $12,325.

The amounts that were given to Rose Goldstein, and recorded by her in the cash journal as the daily receipts of the French Cafe and the Southern Bar, were the amounts entered daily in the "year books" during the years 1942 to May 6, 1946 in the case of the French Cafe and the amounts entered daily in the "year books" during the years 1942 to August 10, 1947, inclusive, in the case of the Southern Bar.

The income tax returns of decedent for 1942 to 1946 inclusive were prepared by Rose Goldstein and she used the check books and the cash journal in preparing these returns. The income tax return of decedent for 1947 was prepared by Emil Reed, and the income of the Southern Bar shown thereon was taken from the cash journal.

The income tax returns of decedent for 1942 to 1947 inclusive did not reflect the amounts withheld, and not recorded in the cash journal, from the receipts of the French Cafe and the Southern Bar.

Overstatement of Purchases for French Cafe. The receipts that were recorded on the daily sheets of the French Cafe and in the year books were always reduced by

amounts actually paid out in cash for supplies and these amounts were frequently characterized as "paid out" or "payouts" on the daily sheets.

The cash journal of the French Cafe reflects cash purchases of $17,872.79 for 1943, $24,140.70 for 1944, $1,279.14 for 1945, and $1,969.91 for 1946. The recording in the cash journal of these amounts, which had already been deducted from receipts on the daily sheets, resulted in a duplication and overstatement of cash purchases.

In addition to the above mentioned cash purchases, purchases made by check, including the amounts of the fictitious purchases (*supra*) added to receipts, were recorded in the cash journal. Purchases for the French Cafe are shown in the cash journal in the amount of $48,339.67 for 1943 and in the amount of $45,906.93 for 1944. Purchases for the French Cafe are shown on the individual income tax returns of decedent for 1943 and 1944 in the amount of $66,791.12 for 1943 and in the amount of $55,944.92 for 1944. Purchases for the French Cafe for 1943 and 1944 are substantially overstated in these returns.

Inventories. The individual income tax return of decedent for 1943 reflected opening and closing inventories for the French Cafe and for the Southern Bar. Prior to that time inventories were not used to determine income.

The individual income tax return of decedent for 1944 reflected an opening and a closing inventory for the Southern Bar. Inventories were not used in subsequent returns to determine income.

The decedent's income tax return for 1943 shows an opening inventory for the French Cafe of $3,500 and a closing inventory of $1,050, and an opening inventory for the Southern Bar of $16,452.65 and a closing inventory of $1,695. His income tax return for 1944 shows an opening inventory for the Southern Bar of $1,695 and a closing inventory of $3,050.62.

Actual inventories were not kept for the French Cafe and for the Southern Bar for the years 1943 and 1944 and the books and records of the French Cafe and Southern Bar do not reflect that inventories were kept for those years. The inventory figures that were used by the bookkeeper to determine income were given to her by the decedent without any verification.

Fraud. The amounts withheld from the gross receipts and not recorded as receipts in the "year books" and cash journal during the years 1942 to May 6, 1946 in the case of the French Cafe and during the years 1942 to August 1947 inclusive, in the case of the Southern Bar, went to the decedent.

The amounts that were withheld and not recorded as receipts, that went to decedent from the Southern Bar for the years 1942 to August 10, 1947, inclusive, were withheld with the knowledge, consent and specific instructions, and frequently with the direct participation of the decedent.

The amounts that were withheld and not recorded as receipts, that went to decedent from the French Cafe for the years 1942 to May 6, 1946, were withheld with the knowledge, consent and specific instructions and frequently with the direct participation of the decedent.

Rose Goldstein was instructed by decedent to show in the cash journal amounts totalling $17,872.79 for 1943, $24,140.70 for 1944, $1,279.14 for 1945, and $1,969.91 for 1946, representing cash purchases of the French Cafe, and these amounts were reflected in purchases when the income tax returns were prepared, even though they had already been subtracted from the receipts of the French Cafe for the years 1943-1946.

When the bookkeeper, Rose Goldstein, had the income tax figures made up for 1943, and showed decedent what tax he had to pay, he told her to "boost" the purchases so he would not have much income tax to pay, or none, and she complied with his instructions.

When the bookkeeper, Rose Goldstein, had the figures prepared to put in the income tax return for 1944, she showed them to decedent who instructed her to raise the purchases, and she complied with his instructions.

Decedent knew that the books and records used to determine income of the French Cafe for the years 1942 to May 6, 1946, and of the Southern Bar for the years 1942 to August 10, 1947 were false and that they did not accurately reflect income.

Decedent knew that his individual income tax returns for the years 1942 through 1947 were false and fraudulent and that he had understated his income in substantial amounts for each of the years.

Decedent's Health. Decedent habitually used alcoholic beverages and at times drank to excess. During the period August 24, 1942 to September 21, 1945, he visited a doctor at least six times. He was under the influence of alcohol on each of these visits and was brought in or assisted into the doctor's office. During the three years the doctor treated decedent there was a decline in his physical health. The doctor treated him for alcoholic neuritis, arthritis, thrombophlebitis and myocarditis.

In the latter part of 1945, decedent was confined to his rooms in the Southern Hotel for a period of three weeks. He employed a practical nurse who cared for him during this period. She remained in his employ until he died. During these three weeks he was in bed most of the time. He had been drinking and not eating. At the end of the three-week period, he had difficulty walking and was in a wheel chair for a short time. Webb was almost a daily visitor to decedent's room during the three-week period.

In 1946 decedent and his nurse moved from the hotel to a house which decedent had purchased. Thereafter, until he had a stroke in December of 1947, he visited the hotel practically every day. His nurse would drive his car. He

did not stay at the hotel very long during these visits. When the hotel was closed in August 1947, decedent was in the lobby nearly every day until the hotel was demolished. Decedent had trouble with his legs and was required to use a wheel chair in 1947. He was under the care of another doctor from the latter part of 1946 until he died. The doctor treated him for marked phlebitis. The first time this doctor hospitalized decedent was in December 1947 when he had the stroke.

At all times material herein, the decedent maintained a close inspection of the books and records of the French Cafe and the Southern Bar, checked on the daily receipts and payouts of these businesses, gave instructions as to the daily and weekend withdrawals from the receipts of these businesses, made it a practice to know everything that was going on, and closely supervised the affairs of these businesses. During the years 1942 through 1946, and until he had a stroke in December 1947, he was mentally alert and had a keen mind in so far as his businesses were concerned.

Webb—Bank Accounts and Deposits. Webb had a personal checking account in the Bank of America during the years 1942 through 1947; and maintained a safe deposit box in that bank where he kept cash. He never deposited any of the receipts from the French Cafe or the Southern Bar in his bank account.

Among the deposits made by Webb in his personal bank account in the Bank of America during the year 1947 were the following:

Date	Amount
May 27, 1947	$1,200.00
May 29, 1947	916.83
May 29, 1947	3,600.00
June 2, 1947	5,000.00
June 13, 1947	1,000.00

Webb was married in 1938. He and his wife lived at the Southern Hotel and received room and board. In 1942 they moved into a completely furnished house owned by decedent which they rented for $40 a month. They had very little expense except the $40 monthly rental since they ate many of their meals at the hotel. From 1938 through 1947 Webb's wife was employed and received a salary of about $150 a month. They tried to save $100 per month and many months they were successful in doing this. They invested some of their savings in war bonds. On or about June 1, 1947, Webb invested $12,000 in the partnership formed to operate the French Cafe. The source of this $12,000 was the proceeds of the sale of war bonds and money in his safe deposit box in the bank. This money was deposited in the Bank of America, and Webb paid $12,000 for his partnership interest.

Bank deposits—Rose Goldstein. Among the deposits made by Rose Goldstein in her personal bank account during the years 1943, 1944, 1945, 1946 and 1947, representing income derived from her business, were the following:

Date	Amount of Deposit
March 9, 1943	$ 946.10
March 19, 1943	468.30
March 17, 1943	1,297.23
September 23, 1943	559.94
July 11, 1944	900.00
March 17, 1945	604.00
January 31, 1946	3,642.88
April 2, 1946	1,000.00
May 9, 1946	1,150.00
June 10, 1946	800.00
June 17, 1946	400.00
September 16, 1946	512.79
September 20, 1946	600.00
October 14, 1946	1,680.00
March 4, 1947	500.00
March 29, 1947	1,902.28
September 19, 1947	2,409.35
August 8, 1947	1,500.00

The total deposits in the personal bank account of Rose Goldstein during the years 1943 through 1947 were as follows:

Year	Total Deposits
1943	$ 5,954.68
1944	3,901.15
1945	3,641.74
1946	14,439.85
1947	12,401.86
	$ 40,339.28

Decedent followed a consistent pattern of deliberately understating receipts of the French Cafe for 1942 to May 6, 1946, inclusive, and of the Southern Bar for 1942 to August 10, 1947, inclusive.

Decedent deliberately overstated purchases for the French Cafe in 1943, 1944 and 1945, despite repeated objections by his bookkeeper.

Decedent caused such books and records as were kept on his behalf to omit specific items of income for the years 1942 to 1947, inclusive, and to overstate specific items that reduced income for the years 1943, 1944 and 1945.

Decedent caused false entries to be made in his books and records for the years 1942 to 1947 inclusive.

Decedent filed false and fraudulent income tax returns for the taxable years 1942 to 1947 inclusive, and part of the deficiencies for each of these years was due to fraud with intent to evade tax.

Opinion

Raum, *Judge*: The Commissioner made a determination of fraud for each of the years involved, 1942-1947, and we think his proof overwhelmingly establishes fraud. The testimony of Robert Webb and Rose Goldstein was strong and convincing, and was in part corroborated by docu-

mentary evidence. Although there may have been minor inconsistencies, the main thrust of their testimony was credible, consistent, powerful, and persuasive. We have no doubt on the evidence that, pursuant to explicit instructions of the decedent, false and fraudulent returns were prepared which understated receipts and overstated purchases. *No useful purpose would be served by reviewing the evidence.* Our finding of fraud not only lifts the bar of the statute of limitations as to 1942-1944,[1] but also supports the application of Section 293(b), Internal Revenue Code of 1939, with respect to the 50 per cent addition for fraud for each of the years involved.

As to the basic deficiencies, the evidence strongly supports the Commissioner's adjustments (including those embodied in his amended answer) as to each item in controversy, except as to the receipts from the Southern Bar for the year 1942, which will be discussed below. Indeed, apart from the year 1942, the evidence would support adjustments of unreported income in excess of those determined by the Commissioner in his notice of deficiency and claimed in his amended answer.[2] Certainly, petitioner has

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[1] No question as to limitations with respect to the remaining years is presently in issue.

[2] Thus, the Commissioner added $13,010 to the income of the French Cafe for the years 1942, 1943, and 1945 and $13,020 for 1944. However, based upon the decedent's practice of understating gross receipts by $10 for each calendar day of the year, as well as by *at least* $100 for each Saturday, Sunday, and holiday, the amount that the Commissioner might have restored to income for each year could have been *at least* $14,550. The latter figure is based upon 365 calendar days at $10 each, 104 Saturdays and Sundays, and five holidays at $100 each. Moreover, the Commissioner would have been justified in adding further an amount for those days in which more than $100 was withheld from gross receipts by the decedent. Therefore, had the Commissioner increased the adjustment of the income of the French Cafe for each of those years by $2,000, such further adjustment would have been fully supported by the record.

shown no error in the Commissioner's determination, and the Commissioner has fully carried the burden which rests upon him in respect of his allegations in the amended answer.

Petitioner contends, however, that income should be determined in accordance with a net worth statement presented to the Court. In the first place, the net worth statement itself shows substantial amounts of unreported income, although less than those determined by the Commissioner's specific adjustments. Moreover, there is no rule of law *requiring* the use of the net worth method. To be sure, the net worth system is an acceptable method of determining income in the absence of a more precise method. But it may be less reliable than adjustments based upon specific items. See in this respect, *Emilie Furnish Funk*, 29 T.C. 279, 291-293, affirmed on this issue, 262 F. 2d 727 (C.A. 9). And, on the present record, we are satisfied that the evidence as to specific items furnishes a more accurate guide to the computation of decedent's net income than the net worth statement.

As to the year 1942, the record requires a revision of the basic deficiency in one respect, because the evidence as to unreported receipts from the Southern Bar supports the Commissioner's determination only in part. Webb testified that the practice of removing $25 a day from the receipts of the Southern Bar began in the "first part" of 1942 and that the practice of removing the larger amounts ($100 or more) on weekends and holidays commenced "a few months after the war started". Subsequently, he testified that the practice of removing the larger amounts from the receipts of the Southern Bar began in the "latter part of 1942". Using our best judgment on the evidence we have found that the receipts from the Southern Bar were understated in the amount of $25 a day for each calendar day throughout the year 1942 and were further understated by at least $100 for every Saturday, Sunday, and holiday dur-

ing the months of October, November and December of 1942. Also, using our best judgment we have found that the aggregate of such understatements of receipts from the Southern Bar was $12,325 for 1942. However, the Commissioner's determination fixes $16,925 as the amount of income from the Southern Bar that was withheld by the taxpayer in 1942 and unreported. Thus, that determination was excessive by $4,600. But, as shown in footnote 2, *supra*, the Commissioner's adjustment in respect of receipts from the French Cafe in 1942 should have been $2,000 more than it was, with the consequence that the *net* determination of additional income for 1942 (of the Southern Bar and French Cafe combined) was excessive by $2,600. Accordingly, the deficiency for 1942 should be recomputed so as to take into account the difference of $2,600, which, however, must in turn be reduced by 50 per cent, since the taxpayer filed a separate return for 1942 on a community property basis.

Petitioner's brief suggests as an issue herein "the question of the survival of the fraud penalty imposed subsequent to the death of the taxpayer." No such issue was raised in the pleadings, and it is not properly before us. Moreover, petitioner's brief admits that the decisions of the Court on that issue are unfavorable to petitioner, and it presents no argument with respect thereto.

Decision will be entered under Rule 50.

TAX COURT OF THE UNITED STATES
WASHINGTON

Docket No. 61480

ESTATE OF WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator with the Will Annexed, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Decision

Pursuant to the Memorandum Findings of Fact and Opinion filed herein June 8, 1959, directing that decision be entered under Rule 50, the parties, on September 10, 1959, filed an agreed computation for entry of decision. It is therefore

ORDERED and DECIDED: That there are deficiencies in income and victory tax and additions to tax as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1942	Income	$ 5,901.47	$ 2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

(Signed) ARNOLD RAUM
Judge

Entered: Sep. 25, 1959